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Answers of the European Financial Congress[1] in relation to the Financial Stability Board's call for public feedback on the effects of the too-big-to-fail (TBTF) reforms for banks[2]

Methodology for preparing the answers

The answers were prepared in the following stages:

Stage 1

A group of experts from the Polish financial sector were invited to participate in the survey. They were sent the FSB's consultation questions. The experts were guaranteed anonymity.

Stage 2

The European Financial Congress received responses from experts representing:

- commercial banks,
- regulatory bodies,
- consulting firms and
- the academia.

Stage 3

The survey project coordinators from the European Financial Congress prepared a draft synthesis of opinions submitted by the experts. The draft synthesis was sent to the experts participating in the survey with the request to mark the passages that should be modified in the final position and to propose modifications and additions as well as marking the passages they did not agree with.

Stage 4

On the basis of the responses received, the final version of the European Financial Congress' answers was prepared.

[1] European Financial Congress (EFC – www.efcongress.com). The EFC is a think tank whose purpose is to promote debate on how to ensure the financial security and sustainable development of the European Union and Poland.
[2] https://www.fsb.org/wp-content/uploads/R230519.pdf https://www.fsb.org/wp-content/uploads/P230519.pdf

Answers of the European Financial Congress

1. *To what extent are TBTF reforms achieving their objectives as described in the terms of reference? Are they reducing the systemic and moral hazard risks associated with SIBs? Are they enhancing the ability of authorities to resolve systemic banks in an orderly manner and without exposing taxpayers to loss, while maintaining continuity of their economic functions? What evidence can be cited in support of your assessment?*

The legislative package regarding recovery and resolution of banks is a step in the right direction on the path to reduce systemic risk without exposing taxpayers to costs, while preserving critical functions of the economy. However, it is too early to answer the above questions conclusively because too few systematically important banks have actually gone through the process in practice.

The bankruptcy law was universal for all business entities and did not take systemic risk into account. The easiest way to reduce systemic risk and moral hazard resulting from the transfer of TBTF bankruptcy risk costs to taxpayers was forced partitioning of banks. However, this solution was not decided on and the concepts of resolution and “bail in” were born, which was reflected in the BRR directive.

It is worth mentioning here that the solution consisting in dividing banks was applied in Poland under the BRR directive in relation to acquired banks with significant portfolios of foreign currency housing loans, so that the risk and liability would remain with the original parent companies which granted such loans (Bank BPH / GE Capital , Raiffeisen Bank Polska, Deutsche Bank Polska). The aim was to eliminate moral hazard in the financial market and to make the original parent companies take responsibility for conducting risky sales strategies. A deviation from this principle was the case when PKO BP took over Nordea Polska, where the parent entity of the acquiring party (the state treasury) gave additional commitments to the Polish Financial Supervision Authority. Thus , the division of banks is possible under the BRRD as part of early supervisory intervention.

Not all regulations have come into force yet, so not all outcomes of them have yet emerged. Moreover, without carrying out a full resolution process with regard to a larger number of banks in accordance with the new rules, it is impossible to make a fair assessment of the strengths and weaknesses of the stipulated solutions, and in particular, whether the created legal framework is appropriate, and whether the new rules effectively lead to the elimination of TBTF pathology and moral hazard. With the provision that only real-life scenario will allow for a full assessment of the new solutions, at this stage it is possible, however, to call into question whether the intended objectives will be fully achieved.

TBTF regulations have two basic objectives:

- Strengthening financial supervision activities aimed to reduce the size of TBTF banks. The increased capital requirement imposed on those banks is meant to cover additional risks related to their size. It raises the costs of TBTF banks' operations and hence stimulates them to reduce their size, which should contribute to enhanced safety of the financial system.
- In case of risk of bankruptcy, forcing the distressed bank as well as its supervision and resolution authorities to effectively carry out the restructuring and/or resolution process in a foreseeable manner.

The demand for capital and subordinated instruments will be great as additional capital buffers and MREL or TLAC may be required not only from TBTF banks but also from smaller ones that are important at the domestic level. Banks may seek to reduce the cost of those regulations by reducing capital requirements.

Even 3.5% of Tier 1 and MREL or TLAC may be additionally imposed on the TBTF bank. This is a big additional burden. Will these incentives be effective? In Poland, the finance minister wanted to induce banks to reduce their portfolios of foreign currency housing loans and imposed a risk weight of 150% on these assets. As a result, in the case of a foreign currency loan with LtV of 100%, the capital charge is currently 12% of the exposure compared to 3.84% for the same loan in PLN, which means that the fact the loan is in foreign currency costs the bank 8.16% of the exposure value. Nevertheless, the banks have not decided to restructure and reduce their portfolios of foreign currency loans and all the currency risk remained with the borrowers.

The effectiveness of regulatory solutions will depend on the attitude of the competent supervision authorities to TBTF banks. The supervision authorities will probably take also political and social implications into consideration to some extent. And here we can observe the main threat to the effective use of the new regulatory solutions. The regulations leave a loophole, allowing the resolution authorities to decide whether a given bank should be liquidated or, because of the public interest, it should be rescued with taxpayers' money. Thus, the resolution or liquidation of a bank ceases to be merely an unavoidable consequence of its bad condition but becomes just one of the options.

Despite the resolution regulations, there are still cases when smaller entities are subjected to ordinary bankruptcy and the state aid is applied to them. It is worth recalling the *casus* of Italian banks, *Veneto Banca* and *Banca Popolare di Vicenza*, restructured by the Italian supervision authority with the use of nonstandard methods and public aid, despite the fact that the BRR directive was already in force. The Single Resolution Board did not identify the existence of public interest to use the resolution procedure and classified the banks as not being systemically important. Nonetheless, the Bank of Italy considered the banks to be systemically important due to their high regional importance, restructured them with the use of contributions by *Atlante* fund and recapitalized *Intesa Sanpaolo* bank, which acquired some parts of the banks. From the formal point of view, the banks entered the process of liquidation, but in fact the supervision authority carried out resolution of them. It can, of course, be said that those were relatively small banks, not falling under the TBTF category. There is no doubt that taking a decision about resolution or liquidation of a TBTF bank would be much more difficult, both because of the consequences of such a decision as well as the power of persuasion that such a large bank has. In the case of the third largest bank in Italy, *Banca Monte dei Paschi di Siena*, public funds were used for precautionary recapitalization.

Resolution of banks is meant to minimize the costs of banks' restructuring borne by taxpayers and to prevent destabilization of financial markets. The decision on restructuring, not to mention the orderly liquidation of a bank, is irreversible, involves immense responsibility and should be perceived as one of the most difficult decisions taken by supervision/resolution authorities. It is no wonder that the resolution authorities may try to shun making such decisions. In the euro area countries the situation is even more complex because the decision process consists of two stages – the ECB (Supervisory Board) takes the decision on bankruptcy and the Single Resolution Board takes the decision on restructuring or liquidation.

Since the entry into force of the BRR directive in 2016 (bail-in), we have not faced a financial crisis on the scale of the 2007-2009 crisis, and the only case of resolution of a distressed bank carried out so far under the control of the EU Single Resolution Board was the use of the takeover instrument with respect to the Spanish *Banco Popular Español*, which at the beginning of June 2017 was taken over by *Santander Bank*. *Banco Popular Español* was the sixth largest bank in Spain. The losses were covered by conversion and write-down of some equity instruments. It allowed to carry out the restructuring process without the use of public funds and to efficiently take over the distressed bank without limiting the access of depositors to banking services. The resolution was carried out in accordance with the new rules and without infecting other European banks.

A good test of the effectiveness of the new regulations will be the authorities' action with regard to Deutsche Bank. The idea of Deutsche Bank merger with Commerzbank had a very strong political endorsement. It was aimed to improve the situation of both the banks, each of them being in a bad financial condition. The merger was to consist of

Deutsche Bank, falling into the TBTF category, taking over the healthier and partially nationalized Commerzbank. One cannot deny that a distressed TBTF bank was to merge with a relatively weak bank, which would have led to the creation of an even greater TBTF bank. This case shows that good regulations are not enough. It is strong and independent supervision/resolution authorities which hold adequate enforcement power that are needed.

Undoubtedly, the increase in own funds and the improvement of their quality reduces the level of systemic risk. However, the level of moral hazard will decrease only if politicians stop increasing the regulatory burden on TBTF banks on the one hand and exerting pressure on them to maintain the scale of crediting the economy on the other hand.

Another reason why it is not yet possible to state that systemic risk and moral hazard have been effectively limited is the fact that banks have not managed to obtain eligible liabilities classified as MREL and the process of calibrating the Basel standards has not been completed. It is also necessary to take into consideration the extent of adjustment of individual states to the expected capitalization standards of deposit guarantee schemes and resolution funds. The legal risks associated with resolution activities will be a particular problem, and the example of legal risks involved in restructuring of *Banco Popular Español* may petrify public authorities in the long run, at least in Europe .

In the European context, actions undertaken by the Single Resolution Board under the resolution regime regarding European banks which were granted the status of FOLTF (failing-or-likely-to-fail) indicate that decisions made by the resolution authorities on the basis of unverified data from the FOLTF institution may result in numerous claims of the bank's creditors, who in the course of court proceedings seek to prove that not taking actions within the resolution framework would be better for them taking into account the no-creditor-worse-off (NCWO) clause.

The management of systemically important institutions with regard to resolution solutions may bring the required results only if the resolution authorities (in Poland, it is the Bank Guarantee Fund- BFG) at the time of conducting the activities required by law have an appropriate level of expertise to make proper decisions in the crisis situation. The quality of documentation prepared by banks as well as their readiness to share relevant data seem to be comparatively high in Poland, which should ultimately allow the BFG to effectively make decisions when/if the resolution process is to be started. So far, we have not observed such activities in Poland in practice and it is difficult to assess TBTF reforms from the perspective of local experience in this respect.

Taking up a bank resolution process may lead to long civil and criminal trials and disputes in international arbitrations (examples of actions in relation to the restructuring of credit unions in Poland are not encouraging). Problems may also occur in case of compulsory acquisition of a bank, which is considered part of the early supervisory intervention introduced into the bank law in Poland ("bank for PLN 1"). In the resolution process, there is also the institution of compulsory acquisition of a bank but it is regulated differently.

From the point of view of macroprudential risk, entities creating the safety net in Poland, in particular the Polish Financial Supervision Authority, have not identified global systemically important institutions (G-SII). They have only identified and annually verify the list of the so-called other systemically important institutions (O-SII). In the case of domestic systemically important institutions, the level of buffers have been determined, and in one case the decision was made to apply this buffer in the amount of 50% of the statutory maximum amount.

Apart from the O-SII buffer, resolution plans have also been implemented in Poland. These tools form part of a wider emergency management process. In order to support the resolution plans, extensive recovery plans and contingency plans have been created, which define the rules of conduct before the intervention of supervision institutions. The plan of conduct, operating principles, identification of sources of capital and liquidity in a crisis situation are tools to reduce the involvement of public funds in case of emergency. These measures will be additionally reinforced by MREL, which (according to BRRD2) will be applicable as of 2022. By that time, the institutions will have to change the funding structure in order to fulfill the MREL levels defined by the BFG.

Discrepancies in the approach to individual solutions at the national level and in the euro area may pose a threat, however. It may cause limitations in the possibility of using, for example, the Single-Point-of-Entry approach at the level of a capital group. This is not the right method for subsidiary banks which are systemically important on local markets of host countries, let alone listed on the stock exchange - at least until a given country (like Poland) is in the Single Supervision Mechanism.

In addition, there is a risk of discrepancies in documentation required by different institutions supervising financial markets in the EU. This requires close cooperation within the framework of the financial safety net as well as an effective dialogue with the banking sector. Resolution principles are easier to implement in the Monetary Union countries. As an external professional body the SRB may conduct restructuring processes with expertise greater than national authorities.

In theory, the objectives of reforms in Poland have been achieved. Reinforcing regulatory requirements for financial institutions have improved the security of these institutions from the point of view of systemic risk and have provided the competent authorities with appropriate control tools and powers in the restructuring process. However, it is difficult to assess whether the TBTF reforms have actually achieved their goals because we have not yet had any situation in Poland when the regulation regarding TBTF banks should be applied to a distressed institution.

Although none of the Polish banks has been classified as G-SII, it should be assessed favorably that the national supervision authorities have selected systemically important banks on a local scale because they meet the classification criteria - size and complexity of operations, links to other financial institutions, irreplaceability in the provision of some services. In accordance with local supervisory practice in Poland, certain solutions resulting from the TBTF/BRRD regime have been extended to institutions other than systemically important ones. As the result of the BRRD being transposed into the Polish legal order as well as of decisions of the supervision authority, smaller institutions are also obliged to draw up recovery plans subject to approval by the Financial Supervision Authority and to review by the resolution authority, which should reduce moral hazard in the Polish banking sector.

Formally, therefore, there has been an increase in the general security of the banking sector in Poland and a number of mechanisms have been introduced into the Polish law which give the competent authorities relatively big powers and the possibility of discretionary action. On the other hand, problems of numerous institutions have become more acute. A disorderly situation persists in many credit unions which are in receivership and are supposed to implement recovery programs. Problems of some cooperative banks are mounting. Two large banks listed on the public market have increased their losses and their own funds are significantly below the required standards. The problems persist despite many new, more and more stringent formal requirements and increased powers of the supervision authorities. In recent years, guaranteed payments in the total amount of over PLN 5 billion were made either from the previously accumulated BFG (Polish bank deposit guarantee scheme and resolution authorities) funds or directly from the banks' funds. The costs were not directly incurred by the taxpayers. In practice, however, the deposit guarantee fund is being rebuilt by the BFG, which seeks to reconstruct partly used funds from bank contributions, and thus indirectly from the banks’ clients. Currently, the economic situation in Poland is very good but the true condition of the sector and the effectiveness of new regulatory solutions will be tested when the economic situation deteriorates significantly.

Summing up, there are not enough cases, at home and abroad, to say that TBTF reforms have reduced systemic risks and moral hazard related to threats created by domestic and global systemically important banks, and that these reforms increase the capacity of competent authorities to dissolve systemically important banks in an orderly manner and without exposing taxpayers to costs, while maintaining the continuity of economic functions. TBTF regulations have achieved their regulatory objectives, but in practice they have not yet been verified on a larger scale. Thus, the TBTF reforms have achieved their objectives partially so far, and the final balance of costs and benefits is not known yet. The independence and credibility of regulatory and supervision authorities is of crucial importance in reducing systemic risks and moral hazard generated by TBTF banks.

2. *Which types of TBTF policies (e.g. higher loss absorbency, more intensive supervision, resolution and resolvability, other) have had an impact on SIBs and how? What evidence can be cited in support of your assessment?*

The most important reforms concerning TBTF banks, in the order of their impact, are:

a) more intense supervision,

b) loss absorption mechanism,

c) resolution,

d) other.

Ad. a)

Intensified supervision over TBTF institutions is a key tool to counter systemic risk and moral hazard associated with threats created by systemically important banks. However, while imposing stricter supervision on systemically important institutions, the less important institutions should at the same time be provided with an adjusted smaller supervisory regime (principle of proportionality). Reinforcement of formal supervision (SREP) in conjunction with the SSM, where supervision is exercised by the ECB and not national authorities, allows for creation of a strong, effective and highly professional supervision, immune to the influence of politicians and banks. The new institutional European supervision architecture consists of two pillars: macro-prudential supervision and micro-prudential supervision.

Ad. b)

Capital requirements and buffers are to ensure the ability to absorb losses by maintaining the required level of eligible liabilities to be converted into equity. This factor determines the development strategies of TBTF banks and at the same time significantly affects their efficiency and the ability to raise funds. Therefore, they may exert even greater pressure on possible mergers (as a way to increase efficiency via cost synergies), including cross-border transactions. This would have practical consequences for current supervision standards (both on a micro and macro scale) and for the assessment of this phenomenon by political decision makers. It seems that supervision authorities and auditors may be too weak (for various reasons) to exercise effective control over them (also in Poland). At the global level, the FSB introduced a new prudential standard - TLAC. In turn, in the European Union, the BRR directive introduces the so-called minimum requirement for own funds and eligible liabilities (MREL). As a consequence of the new regulations, it is necessary to increase capital to cover losses and eliminate or reduce the costs of state aid as well as increasing market discipline. This results in the need to issue new convertible debt instruments by banks that have so far mainly been financed by deposits. Creating a market for this type of instruments in the short term will pose a significant challenge for the banking sector. The necessity of raising capital and obtaining additional financing through unprivileged debt means a higher cost of raising capital, an increase in the cost of financing, lower competitiveness, inferior profitability (ROE/ROA), as well as difficulties in finding investors for TBTF banks. After the adoption of the BRRD, most of the countries implemented the new regulations but each in a slightly different manner. This means that investors in subordinated bank bonds (non-preferred senior) must become familiar with local regulations. The situation gets complicated in the case of liquidation of a banking group operating in many countries. This leads to legal uncertainty for investors, resolution authorities and banks themselves planning to issue debt.

Due to the significant impact on banks, MREL/TLAC are implemented relatively slowly. They require a change in thinking about financial institutions and financing them, but also a different approach to bankruptcy. Until now, bankruptcy has involved, in simple terms, the loss of capital and the repayment of deposits from guarantee schemes. Now most of the losses will be incurred by the enterprise sector, shareholders and holders of qualified instruments. The MREL/TLAC requirement generates a disciplinary effect on banks. Banks issuing eligible liabilities are aware that the price of debt depends on the financial condition of the issuer, therefore they should consistently care about the financial situation of their companies so that the cost of fulfilling the requirement will be as small as possible. The TLAC requirement has been implemented in the European legal system only in CRR2 and will come into force on June 27, 2019. A detailed analysis of the use of this requirement by European banks will be possible after reaching the target level. In the Polish financial system no global systemically important institutions (G-SII) have been identified, to which TLAC applies, hence the risk buffer for other systemically important institutions (O-SII) is of fundamental significance on the domestic market.

In Poland, the main effect of the regulatory changes is an increase in the ratio of capital adequacy of banks. Before the crisis, 8% was considered a safe level. Currently, in the case of the most capitalized Polish banks, this ratio has more than doubled due to the introduction of several capital buffers . The buffers are modified from time to time, which increases the degree of uncertainty, hinders planning and operations, forcing banks to maintain additional, internal buffers for unexpected regulatory changes. The regulations force banks to significantly increase own funds. In the years 2010 - 2018, the own funds of Polish banks almost doubled (from PLN 116 billion to PLN 205 billion). As a result, the capital adequacy of Polish banks has increased from around 14% to around 19%, so the general security of the banking sector and deposits accumulated in it has improved. (Part of the increase in own funds was additionally forced by restrictions imposed by the regulator on the dividend payout, which particularly affected banks with foreign currency mortgage loan portfolios.)

At the same time, the charges for the BFG have increased drastically. While in 2010 they amounted to PLN 0.3 billion, in 2018 they reached PLN 2.1 billion. Contributions to the BFG are high and the pace of reaching the target level of the contributions is very fast, especially if one takes into account that the ratio of the accumulated fund to the amount of deposits covered by guarantees is many times higher in Poland than in most EU countries. In addition, the target amount of BFG fund is set at a higher level than that resulting from the DGS and BRR directives.

(The BFG Act changed the rules for calculating bank contributions, and limited the possibility of including them into tax deductible costs. The BFG contribution is paid from profit after tax, even though as a statutory charge it should be a component of tax deductible costs. Those changes were coupled with a significant depletion of the BFG fund resulting from the payment of guaranteed deposits for savers in bankrupt credit unions and a bankrupt large cooperative bank. In addition, the capital situation of Polish banks is aggravated by the bank tax on assets. Its rate is considerably higher than in other countries. It has a distorting effect on credit and market activities of banks. The effect of the regulations is such that since 2010 the value of charges imposed on banks has more than tripled, from just over PLN 3 billion to nearly PLN 11 billion, and their relation to gross profit from just over 20% to over 45%.)

The new regulations reduce the banks' ability to improve their financial results and deteriorate key performance indicators. In 2010, the first after the slowdown in 2009, the amount of receivables from the non-financial sector in Poland amounted to nearly PLN 700 billion, the own funds to PLN 116 billion, and the financial result to PLN 11.4 billion. The RoE was just over 10% and the RoA was 1.03%. In much better 2011, those rates amounted to 12.9% and 1.26%, respectively. The results were so good that the Polish banking sector was perceived as stable, effective and attractive to potential investors. This was confirmed by both successful public issues of banks' shares as well as serious investments of foreign investors in existing and new banks.

Currently, the situation of the sector in terms of efficiency does not look so good. Receivables of banks from the non-financial sector have increased to PLN 1,089 billion, i.e. by more than 55%, while own funds have almost doubled to PLN 205 billion. Last year, the financial result of the Polish banks amounted to PLN 13.3 billion, only 16% more than in the bad 2010 and 15% less than in 2011. RoE has fallen to 6.5%, and RoA to just 0.72%. Thus, a significant deterioration in the efficiency of the Polish banking sector can be observed in that period. As a result, it becomes less and less attractive to potential investors. This unfavorable trend is caused by two parallel factors: increased burdens imposed on banks leading to a decrease in the net results and the need to increase own funds. When it becomes necessary to ask investors for additional capital, they may be uninterested because they will have other, more attractive investment opportunities.

The decline in the attractiveness of the banking sector will cause difficulties for the Polish banks to meet the MREL requirement, especially considering that the domestic capital market is not as developed as capital markets in other European countries. Polish banks are mainly financed with deposits, which are not included in MREL. Therefore, the fulfilment of the MREL requirement (in2023 - according to the BFG policy, or in 2024 - according to BRRD2) will require a change in the structure of banks' liabilities, to increase the share of non-preferred senior debt instruments. Placing such debt issues will be difficult due to the low attractiveness of Polish banks and the fact that the same requirements will apply throughout Europe, so at the same time the supply of these instruments from foreign banks will increase. The target MREL limit is based on capital requirements, which are relatively high in Poland. That will cause high MREL limits for Polish banks. It is estimated that the additional volume of MREL-eligible debt instruments may amount to approx. PLN 60-100 billion. The costs of issuing the instruments will be higher than for the non-subordinated instruments (and incomparably higher than the cost of financing with deposits), which will lead to a further decline in the profitability and efficiency of Polish banks. It may be necessary for them to increase hard capital. It can be anticipated that higher costs of banks will be transferred to clients. For these reasons, it is difficult to unambiguously assess the effects of regulatory changes. On the one hand, we deal with a formal - albeit disproportionate to the economic growth of the country - development of the banking sector and current, overall improvement of its security due to the huge increase in the sector's own funds as a whole. On the other hand, this is accompanied by a drop in efficiency indicators, which may have a negative impact on the banking sector in the future.

Ad. c)

The mechanism of restructuring and orderly liquidation of banks gives public institutions new tools and powers with regard to the rights of bank owners and creditors. Although the introduction of private sector solution applies to all banks, in the case of TBTF banks, shareholders have more to lose, so they may be more interested in reducing the capital requirement. The following issues are crucial in this context: preparation of resolution strategies, development of bail-in playbooks and cyclical resolvability tests. Resolution also includes recovery plans and contingency plans. For a TBTF institution, it means specifying actions to be taken in a situation of crisis and identifying ways of dealing with it. It is important to identify not only financial but also operational connections.

Ad. d)

Among other reforms and principles affecting SIBs, (liquidity requirements - LCR/NSFR, amount of contributions to the resolution fund, requirements regarding the principles of determining remuneration and corporate governance, and new accounting standards), NSFR requirements will have the biggest impact on large domestic banks in some countries. For example, the scale of mismatch of maturities of assets and liabilities in the Polish banking sector is considered the greatest threat to its stability.

3. *Is there any evidence that the effects of these reforms differ by type of bank (e.g. global vs. domestic SIBs)? If so, what might explain these differences?*

The reforms were prepared for banks that are systemically important and operating globally, but they also affect smaller domestic banks. From the perspective of the specificity of the Polish financial market, there are currently no experiences with regard to assessment of impact of TBTF reforms on global systemically important institutions (G-SII). For these reasons, at this stage, it is not possible to distinguish the effects of the reform on G-SII and O-SII.

The difference seems to be primarily quantitative rather than qualitative. In the case of domestic banks, we deal with a significantly smaller scale of operation and correspondingly lower costs of protection, with possibly less significant losses and a narrower “contagion” area. The possibilities to counteract threats, such as financing the deposit guarantee system or providing financial support for resolution processes through contributions submitted by institutions operating on the local market, are also limited, so the relative weighting of the effects may be comparable. The problems of TBTF and smaller banks are similar because local banks holding a systemic position in real life duplicate the behavior of global banks. This results not only from their actual market position, but also from similar business and management models propagated by several global consulting companies.

In the case of local banks, all decisions remain at the discretion of the national authorities, which simplifies the entire procedure, while in the case of global banks, reaching agreement between various institutions will be much more cumbersome.

4. *What have been the broader effects of these reforms on financial system resilience and structure, the functioning of financial markets, global financial integration, or the cost and availability of financing? What evidence can be cited in support of your assessment?*

The post-crisis activities in the EU have made the banks reduce the level of leverage (deleveraging) and increase their capital in accordance with the Basel III recommendations. Capital adequacy ratios across the EU exhibit an upward trend. The effect of reforms is an increase in the stability of the financial system. However, small banks (e.g. in Poland) even today pay for the problems of large banks, in the form of very stringent capital requirements. The introduction of MREL will translate into higher bank capitals, but it may have a negative impact on economic growth and lead to high costs of issuing MREL-eligible bonds, which will cause a drop in the net profit of the banking sector. The challenge is the limited capacity of less developed markets (e.g. Poland) that will not be able to absorb such large issues, therefore the more expensive foreign bond issues will be an alternative. The issues of these instruments will be connected with a relatively high risk, which means that banks will have to pay dearly for getting MREL. Another consequence may be even greater pressure to consolidate the banking sector due to low profitability.

The effect of TBTF reforms is enhanced and orderly functioning of these institutions and stronger capital backing. International supervisory cooperation and the quality of financial market analysis, including its impact on the entire economy, have improved. However, confidence in markets and financial institutions has not been fully restored. Non-standard activities are still undertaken by central banks, and they disturb the market competition as well as leading to higher operating costs of commercial banks. These activities may in the near future lead to further tensions in the markets due to excessive supply of cheap money (price bubbles) and artificially created demand (mainly in the field of consumption as an alternative to stagnation in investments). The cost of money, which is determined by the level of market interest rates, remains uncertain, due to the need to take into account various risk factors or increased demand (for example, when all institutions want to accumulate required TLAC/MREL capital resources by specified date, or in the case of intensified purchases of “safe” assets).

The proposed and implemented changes significantly increase the burden on banks both from the financial and operational side. Greater dependence on convertible instruments will increase their interest rates. This increase may be significant due to the limited absorption capability of the market. On the operational side, it is necessary to create dedicated teams dealing with supervisory cooperation in the context of new regulations and to develop special IT tools for collecting and transferring data. This will increase the barriers to market entry, and, if there is no increase in revenue from operations, the operating costs will increase, which will negatively affect the attractiveness of the banking offer to clients. As a consequence, one can expect an increase in market concentration and further marginalization of smaller entities. In Poland, this may lead to even higher nationalization of the banking sector (currently about 40% of assets are controlled by the state), due to the withdrawal of international banking groups from the market and further loss of the market by cooperative banks.

The TBTF reforms may result in the rationalization and realignment of distribution among individual financial institutions (banks) of the amount of contributions to deposit guarantee schemes (DGS) or to resolution funds. TBTF reforms stimulate greater safety, but they reduce the profitability of banks at the same time. These reforms do not take into account the effectiveness and competitiveness of the banking market. Greater consolidation would allow for easier supervisory control and bank cost optimization, but for customers it would mean less diversity and could lead to the replacement of the relationship banking by transactional banking, fostering further dynamic development of the unregulated segment of fintech businesses that may themselves endanger the stability of the financial market, while at the same time exerting pressure on the increase in the size of banks, many of which are already TBTF.

This process has not yet been completed, so inevitably the assessment is incomplete. The full assessment will be possible only in a few years' time. Provided the implementation is finalized, it may be assumed that the regulatory mechanisms in combination with the activities of supervisors will discourage banks from remaining in the TBTF category, and the decrease in the scale of their operations will reduce the risks, hence enhancing the stability of the financial system. If banks act in accordance with the regulatory requirements, one can expect "slimming down" of banks, most likely by deleveraging or selling their separated parts. It is rather unlikely that the separated parts of banks operations will be transferred to unregulated shadow banking institutions because the difference in the scale of operations between regular banks and shadow banking institutions is huge.

The challenge for introducing MREL in Poland is the structure of banks' balance sheets, in which deposits dominate, as well as the structure of the debt market dominated by Treasury bonds, with a marginal segment of bank debt. The micro- and macroeconomic effects will be exacerbated due to the further increase in capital requirements under CRD V, CRR 2.0 and the upcoming Basel IV.

5. *Have there been any material unintended consequences from the implementation of these reforms to date? What evidence is available to substantiate this?*

The relatively short “history” of the impact of TBTF reforms, their immeasurability and lack of information base make it difficult to fully assess the consequences of these regulations. As a result, they still arouse much controversy and distrust, especially in countries which were not directly hit by the crisis of 2007-2009 (e.g. Poland).

Reforms, on the one hand, increase the safety of the financial system by limiting the risk of bankruptcy of banks, but on the other hand, they can limit the economic growth. The changes introduced have a positive impact on the reduction of systemic risk, but they can still generate the risk of moral hazard. Access to rescue funds in countries where banks are particularly exposed to risk may be an additional incentive to use the funds extensively and may create a real possibility of regulatory arbitrage.

The eligible securities issue means additional financing costs for banks that will impact profitability. In order to reduce costs, banks may want to pass costs related to regulatory changes onto clients or seek more profitable and hence riskier investments (e.g. corporate bonds). Paradoxically, a system designed to reduce the risks associated with the functioning of the banking sector may lead to accumulation of this risk.

The changes are just being implemented and currently there is no way to clearly determine whether they are successful. A lot has been achieved in the field of preparation for action in a situation of crisis, but will these measures prove adequate, precise and sufficient? Limiting the decision-making flexibility might be a problem because of a rigid system of stages in the procedures, while crises are phenomena that go beyond the standard cognitive process.

TBTF regulations create new challenges such as acquiring new investors for banks while profitability of capital is decreasing or meeting reporting requirements which are on the continuous increase (reporting for supervisory purposes and for preparing resolution plans, as well as resulting from the requirements of the Basel - public disclosure in the field of risk management). The new regulations favor consolidation and lead to weakening of cooperative banks in countries with a decentralized cooperative model (e.g. Italy, Poland). There is resistance to using the bail-in tool in relation to bondholders. It has led to the creation of various banking or government funds to compensate the banks for losses - which results in chaos and potentially contributes to systemic risk.

Introducing locally acceptable levels of macro-prudential buffer indicators in the banking system is not always justified by a real assessment of the economic cycle. The vast majority of domestic financial institutions use standard methods of determining capital requirements without realizing benefits connected with the use of advanced methods that bring capital savings. It may cause the local financial institutions, in relation to which relatively high capital requirements are formulated, to become non-competitive in terms of capital as compared to EU financial institutions. Hence, closer supervision of global TBTF institutions is necessary so that smaller, local banks can compete effectively with large European entities.